Federal Financing Bank

Financial Statements
for the Quarter Ending
December 31, 1998

FEDERAL FINANCING BANK
STATEMENT OF FINANCIAL POSITION
FOR THE QUARTER ENDING
Unaudited

	December 31, 1998	September 30, 1998
ASSETS	In Thousands	
Funds with U.S. Treasury	266,392	348,163
Loans Receivable	44,311,259	46,141,863
Allowances for Losses	(217,269)	(263,462)
Advances to Others	112	413
Accrued Interest Receivable	624,201	505,168
Total Assets	**44,984,695**	**46,732,145**
LIABILITIES AND NET POSITION		
Liabilities		
Borrowings from SOT	29,304,944	34,176,490
Borrowings from OPM	14,999,990	14,999,990
Borrowings from Public	10	10
Accrued Interest Payable	616,326	835,709
Other Liabilities	260	194
Total Liabilities	44,921,530	50,012,393
Net Position		
Unexpended Appropriations	238,507	0
Transfers to Treasury	(1,682,846)	(1,682,846)
Cumulative Results of Operation	1,507,504	(1,597,402)
Total Net Position	63,165	(3,280,248)
Total Liabilities and Net Position	**44,984,695**	**46,732,145**

The accompanying notes are an integral part of these financial statements.

FEDERAL FINANCING BANK
STATEMENT OF OPERATIONS AND CHANGES IN NET POSITION
FOR THE QUARTER ENDING
Unaudited

	December 31, 1998	September 30, 1998
	In Thousands	
Revenue and Financing Sources		
Interest on Loans	483,615	1,278,601
Appropriations Used	4,234,251	0
Total Revenue and Financing Sources	4,717,866	1,278,601
Expenses		
Interest on Borrowings	487,211	1,261,927
Other Expenses	1,127,075	25,883
Administrative Expenses	345	488
Total Expenses	1,614,631	1,288,298
Excess (shortage) of Revenues and Financing Sources over Total Expenses	3,103,235	(9,697)
Net Position		
Transfers to Treasury	(1,682,846)	(1,682,846)
Cumulative Results of Operation	(1,597,402)	(1,587,762)
Net Position, beginning balance	(3,280,248)	(3,270,608)
Adjustments	1,671	0
Net Position, beginning balance as restated	(3,278,577)	(3,270,608)
Prior Period Adjustments	0	57
Excess (shortage) of Revenues and Financing Sources over Total Expenses	3,103,235	(9,697)
Unexpended Appropriation	238,507	0
Net Position, ending balance	63,165	(3,280,248)

The accompanying notes are an integral part of these financial statements.

FEDERAL FINANCING BANK
STATEMENT OF CASH FLOWS
FOR THE QUARTER ENDING
Unaudited

		December 31, 1998 In Thousands
CASH FLOWS FROM OPERATIONS		
Net income (loss)	3,103,235	
Adjustments to reconcile net income (loss) to net cash provided:		
(Decrease) increase in allowance for losses	(46,193)	
Decrease (increase) in accrued interest receivable	(113,424)	
(Decrease) increase in accrued interest payable	(223,186)	
Decrease (increase) advances to others	301	
(Decrease) increase in other liabilities	66	
Net cash from operations		2,720,799
CASH FLOWS FROM INVESTING ACTIVITIES		
Loan disbursements	(106,041,713)	
Principal collections	107,868,379	
Net cash from investing activities		1,826,666
CASH FLOWS FROM FINANCING ACTIVITIES		
Appropriations	238,507	
Borrowing	109,117,974	
Repayments of borrowing	(113,985,717)	
Net cash from financing activities		(4,629,236)
Net (decrease) increase in cash		(81,771)
Cash -- beginning of the period		348,163
Cash -- end of the period		266,392

The accompanying notes are an integral part of these financial statements.

Federal Financing Bank

Notes to the Financial Statements

Quarter Ending
December 31, 1998

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Federal Financing Bank (the Bank) was created by the Federal Financing Bank Act of 1973 (12 USC 2281, the "Act") as an instrumentality of the U. S. Government and a body corporate under the general supervision of the Secretary of the Treasury. The budget and audit provisions of the Government Corporation Control Act are applicable to the Bank in the same manner as they are applied to other wholly owned Government corporations.

The Bank was established by Congress at the request of the Treasury Department (Treasury), in order "to assure coordination of Federal and federally assisted borrowing programs with the overall economic and fiscal policies of the U. S. Government, to reduce the cost of Federal and federally assisted borrowing from the public, and to assure that such borrowings are financed in a manner least disruptive of private financial markets and institutions." The Bank was given broad statutory authority to finance obligations issued, sold, or guaranteed by Federal agencies so that the Bank could meet these debt management objectives.

The Bank is authorized, with the approval of the Secretary of the Treasury, to issue obligations to the public in amounts not to exceed $15 billion. Additionally, the Bank is authorized to issue obligations in unlimited amounts to the Secretary of the Treasury and, at the discretion of the Secretary, may agree to purchase any such obligations.

Basis of Accounting

The financial statements are prepared in accordance with generally accepted accounting principles for commercial enterprises and, therefore, are presented on the accrual basis of accounting.

Funds with U. S. Treasury

As a Government corporation, the Bank maintains a fund balance with Treasury (fund account 20X4521) and does not hold cash. The fund balance includes appropriated funds. For the purposes of the Statement of Cash Flows, the funds with Treasury are considered cash.

Interest on Loans

The Bank's general policy is to charge borrowers a fee of one-eighth of one percent more than its cost of borrowing from Treasury. The income resulting from the fee covers the administrative expenses of the Bank, and any surplus is transferred to the Treasury's General Fund.

Loan Servicing Fee

The Bank charges the Civil Service Retirement Fund (CSRF) a fee to service the loans receivable of Tennessee Valley Authority (TVA) and United States Postal Service (USPS) acquired from the Bank during an exchange of Treasury securities. The fee is equal to one-eighth of one percent more than the contractual interest rate with Treasury. These loans have maturity dates ranging from June 1, 1999, to May 16, 2005.

Allowances for Loan Losses

Loan principal and interest are generally guaranteed by federal agencies and are backed by the full faith and credit of the U. S. Government. Direct loans to USPS are an exception since the U. S. Government does not guarantee them. Loans receivable from USPS as of December 31, 1998, were fully collectible; accordingly, no allowance for loan losses was recorded. The Bank has not incurred, and does not expect to incur, any credit-related losses on its loans. However, the Bank, incurs losses related to certain legislation and has recorded an allowance for loan losses related to this legislation.

The Bank calculates its allowance for loan losses based on the total amount of future interest credit that it expects to provide to RUS discounted at the effective interest rate on the underlying loans. The allowance for loan losses is based on estimates, and ultimate losses may vary from current estimates. Adjustments to the allowance for loan losses are reported in the period that they are determined to be necessary.

Activity in the allowance for loan losses account for the quarter ended December 31, 1998 is as follows:

Allowance for loan losses at September 30,1998	$263,462
Interest credit	(40,174)
Adjustment based on estimates	(6,019)
Allowance for loan losses at December 31,1998	$217,269

Management's Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Related Parties

The Bank is subject to the general supervision and direction of the Secretary of the Treasury. As provided by law, the Secretary of the Treasury acts as Chairman of the Board of Directors. Employees of Treasury's departmental offices perform the Bank's management and accounting functions; its legal counsel is the General Counsel of the Treasury. The Bank reimburses Treasury for facilities and services that it provides.

2. LOANS RECEIVABLE

Loans receivable includes agency loans purchased, direct loans to federal agencies, and loans to nonfederal entities. Agency loans purchased are either notes or pools of loans sold by federal agencies in the form of certificates representing shares of ownership in the loan pool. The selling agencies guarantee the principal and interest repayments on the notes or certificates. Direct loans to agencies are debt securities issued to the Bank by agencies that Congress has authorized so that these federal agencies can finance their activities. These include loans made to USPS. Loans to nonfederal entities are loans made to nonfederal borrowers whose obligation to repay the principal and interest is guaranteed by a federal agency. Loans receivable consists of the following:

Agency	**(in thousands)**
Agency Loans Purchased	December 31, 1998
Farmers Home Administration, Department of Agriculture	$13,175,000
Medical Facilities, Department of Health and Human Services	7,179
Health Maintenance Organization, Department of Health and Human Services	3,090
Rural Utilities Service (CBO), Department of Agriculture	4,598,907
Total Agency Loans Purchased	**17,784,176**
Direct Loans to Agencies:	
U. S. Postal Service	4,110,700
Total Direct Loans to Agencies	**4,110,700**

Agency	(in thousands)
Guaranteed Loans to Nonfederal Entities:	
Foreign Military Sales, Department of Defense	2,782,329
General Services Administration	2,631,543
Community Development Block Grants, Department of Housing & Urban Development	15,411
Low Rent Public Housing, Department of Housing & Urban Development	1,419,965
Ship Leasing, Department of Defense, Navy	1,224,931
Rural Utilities Service, Department of Agriculture	14,091,228
Small Business Administration	223,975
Virgin Islands, Department of Interior	17,475
Historically Black Colleges and Universities, Department of Education	6,337
Federal Railroad Administration, Department of Transportation	3,789
Total Guaranteed Loans to Nonfederal Entities	**22,416,983**
Allowance for Loan Losses (Note 1)	(217,269)
Discount	(600)
Total Loans Receivable	**$44,093,990**

3. BORROWINGS

The Bank finances its loan portfolio primarily by borrowing from the Treasury. Under the Federal Financing Bank Act of 1973, the Bank may, with the approval of the Secretary of the Treasury, borrow without limit from the Treasury. On September 18, 1998, the liability for the debt prepayment premium, foregone interest and related accrued interest, as discussed in Note 4, was repaid to the Secretary through the issuance of an additional $3 billion loan to the Bank. At December 31, 1998, the Bank had outstanding advances owed to Treasury of $29.3 billion, with interest rates ranging from 4.731 percent to 16.241 percent, and maturity dates from January 1, 1999, to December 31, 2031.

Additionally, the Bank had borrowings of $15.0 billion from the Civil Service Trust Fund, which is administered by the Office of Personnel Management (OPM). These borrowings are at interest rates ranging from 8.75 percent to 9.25 percent, and with maturity dates ranging from June 30, 2003, to June 30, 2005.

4. DEBT PREPAYMENT PREMIUM AND FOREGONE INTEREST

Debt Prepayment Premium

Under the terms of its master promissory note with Treasury, the Bank must liquidate its borrowings with Treasury at the same time as loans receivable financed by those borrowings is liquidated. The Bank's normal policy is to match the maturity and, except for a one-eighth of one percent spread, the interest rate on its loans receivable with the interest on its borrowings. In addition, for most of its loans, premiums or discounts resulting from loan prepayments are equivalent to the premiums or discounts the Bank paid or received when it simultaneously prepaid its Treasury borrowings. Premiums or discounts arise to the extent that market interest rates at the prepayment date differ from rates stated in the loan agreements. The effect of these policies is to mitigate the Bank's risk from interest rate fluctuations.

However, Congress authorized certain RUS guaranteed borrowers to prepay their loans at par rather than market value up to a specified dollar limit. Further, legislation also authorized borrowers in the foreign military sales program guaranteed by Department of Defense to prepay, at par, certain loans meeting specific criteria.

The effect of these statutes was to waive premium payments to the Bank, which would otherwise have resulted from the fact that interest rates at the dates of prepayment were less than the rates in the loan agreements. Notwithstanding the fact that the borrowers' premium was waived, the Bank remained liable for premiums due on its debt to the Treasury and incurred prepayment penalties.

Foregone Interest

Under Title III of the Rural Electrification Act of 1936, the Bank receives interest on certain loans to RUS at an interest rate which is less than the contractual interest rate stated in the loan agreements with RUS. This interest credit is calculated based on the balance in an RUS Liquidating Fund. The Bank has no control over the balance in the RUS Liquidating Fund. The Bank must, therefore, absorb the cost of the interest credit (i.e., foregone interest) since it has recourse against RUS. The Bank, however, remains obligated to pay the contractual interest on its borrowing from Treasury.

Statement of Financial Accounting Standards No. 114, "Accounting by Creditors for Impairment of a Loan," requires that impaired loans should be measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or based on the fair market value of the loan or underlying collateral. Statement of Financial Accounting Standards No. 114 considers a loan to be impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the original agreement.

Management of the Bank has determined that certain RUS loans are impaired as defined by SFAS No. 114 since the Bank will not receive all interest due in accordance with the original terms of the loan agreements. The Bank implemented the requirements of SFAS No. 114 effective October 1, 1996 and corrected its accounting for allowances for loan losses.

5. REVENUE AND FINANCING SOURCES

The Bank's primary source of revenue is interest earned through loans to Federal agencies. However, Public Law 105-277, approved October 21, 1998, appropriated $3.3 billion to the Bank to liquidate certain Treasury debts and $1.2 billion to repay the CSRF for premium owed on a par prepayment as discussed in Notes 4 and 6. The appropriation will expire on September 30, 1999.

6. OTHER EXPENSES

Section 103(1) of Public Law 105-277 allowed TVA to repurchase bonds at par which were originally held by the Bank and transferred to the CSRF in February 1996. Section 103(3) provided that the Bank be appropriated such amounts as may be necessary to pay the difference between the amount that TVA paid to prepay its outstanding loans and the amount that would have been received based on the original contractual terms.

The Bank was appropriated $1.2 billion which it used to repay the CSRF for premium due on the prepayment. The Bank retained one-eighth of one percent for the servicing fee.

7. NET POSITION

As a result of the legislation that results in the foregone interest and the loan prepayments as described in Note 4, the Bank incurred significant operating losses in prior years. It was unlikely that the Bank's net interest earnings at the current spread would be sufficient to fund its liability and eliminate its accumulated deficit. However, Public Law 105-277, approved October 21, 1998, appropriated $4.5 billion to the Bank to liquidate this debt and to repay the CSRF for premium owed on a par prepayment as discussed in Notes 4 and 6.

8. FAIR VALUE OF FINANCIAL INSTRUMENTS

Funds with U. S. Treasury

The carrying amount approximates fair value because of the liquid nature of the funds with Treasury.

Loans Receivable and Borrowing

The fair value of loans receivable and borrowings is calculated using discounted cash flow analyses based on contractual repayment terms. The discount rates used in the loans receivable analysis are based on interest rates currently being offered by the Bank on loans of similar maturity and other characteristics. The discount rates used in the borrowings analysis are based on interest rates of current borrowings from Treasury using similar maturity and other characteristics.

Accrued Interest Receivable, Accounts Receivable, Accrued Interest Payable, Other Liabilities

These assets and liabilities are stated on the Statement of Financial Position at the amount expected to be realized or paid.

9. COMMITMENTS AND CONTINGENCIES

Nearly all of the Bank's loans are to federal agencies or to private sector borrowers whose loans are guaranteed by a federal agency. When an agency has to honor its guarantee because a borrower defaults, that agency must obtain an appropriation or use other resources to pay the Bank. However, if an appropriation is not granted or federal agencies are not allowed to fund the losses by borrowing from the Treasury, and the Bank is legislatively required to absorb the debt the agency owes it, the Bank would incur a loss. The Bank has incurred such a loss related to forgone interest as described in Note 4. Management of the Bank has established an allowance for loss related to forgone interest expected to be incurred in the future.

10. PENSIONS AND ACCRUED ANNUAL LEAVE

Either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS) covers virtually all of the employees whose salary cost is allocated to the Bank by Treasury. For CSRS employees, Treasury withholds a portion of their base earnings. Treasury then matches the employees' contributions and the sum is transferred to the Civil Service Retirement Fund, from which the CSRS employees will receive retirement benefits. For FERS employees, Treasury withholds, in addition to social security withholdings, a portion of their base earnings. Treasury contributes an amount proportional to the employees' base earnings towards retirement and a scaled amount towards each individual FERS employee's Thrift Savings Plan, depending upon his/her level of savings. The FERS employees will receive retirement benefits from the Federal Employees Retirement System, Social Security System and the Thrift Savings Plan deposits that have accumulated in their accounts.

Although Treasury funds a portion of pension benefits under the Civil Service and Federal Employees Retirement Systems relating to its employees and makes the necessary payroll withholdings from them, it has no liability for future payments to employees under these programs and does not account for the assets of the Civil Service and Federal Employees Retirement Systems, nor does it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by OPM for the Retirement Systems and are not allocated to the individual employers. The Office of Personnel Management also accounts for health and life insurance programs for retired civilian federal employees. Similar to the accounting treatment afforded the retirement programs, the actuarial data related to the health and life insurance programs is maintained by OPM and is not available on an individual employer basis.